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 INFO RUEHDC/USDOC WASHDC  
 RUMTBK/AMEMBASSY BANGKOK 6208  
 RUEHJA/AMEMBASSY JAKARTA 2294  
 RUEHKL/AMEMBASSY KUALA LUMPUR 2449  
 RUEHML/AMEMBASSY MANILA 6929  
 RUEHMO/AMEMBASSY MOSCOW 7330  
 RUFHFR/AMEMBASSY PARIS 2717  
 RUEHUL/AMEMBASSY SEOUL 5068  
 RUEHGP/AMEMBASSY SINGAPORE 4569  
 RUEHKO/AMEMBASSY TOKYO 7777  
 RUMJNG/AMCONSUL HONG KONG 2622  
 RUEHIN/AIT TAIPEI  
 RUHQHQA/CINCPAC HONOLULU HI  
 RUFHNA/USMISSION USNATO 1792  
 RUEHCR/AMCONSUL GUANGZHOU 1204  
 RUMJSA/AMCONSUL SHANGHAI 1879  
 ZEN/AMCONSUL SHENYANG POUCH  
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 C O N F I D E N T I A L BEIJING 05916

PARIS FOR OECD

E.O. 12356: DECL: OADR  
 TAGS: ECON, EFIN, EIND, CH  
 SUBJECT: CHINESE ECONOMIC PLANNER SAYS ATTACK ON  
 "UNHEALTHY TENDENCIES" WILL NOT SLOW ECONOMIC REFORM

REFS: A) BEIJING 5064, B) BEIJING 5523, C) HONG KONG  
 - 3804

1. CONFIDENTIAL- ENTIRE TEXT.  
 2. SUMMARY: THE CURRENT ATTACK ON "UNHEALTHY  
 TENDENCIES" IN THE ECONOMY WILL NOT SLOW THE PACE  
 OF REFORM, ACCORDING TO CONVERSATIONS WITH CHINESE  
 ECONOMIC PLANNERS. RATHER, THE ATTACK IS AN ATTEMPT  
 TO REMOVE OBSTACLES WHICH MIGHT HINDER THE SMOOTH  
 IMPLEMENTATION OF THE NEXT REFORM STEPS--PARTICULARLY  
 WAGE AND PRICE REFORM. WE BELIEVE NEVERTHELESS THAT  
 THE ATTACK WILL DAMPEN THE ENTHUSIASM FOR EXPERIMEN-  
 TATION WHICH THE REFORMS HAVE PURPOSEFULLY AND  
 SUCCESSFULLY FOSTERED. THE EXTENT OF THIS DAMPENING  
 WILL DEPEND ON THE DURATION AND SERIOUSNESS OF THE  
 ATTACK.

3. OUR SOURCES ALSO SAID THE CURRENT SYSTEM OF  
 MULTIPLE PRICES WILL LAST FOR SOME TIME. SPECIFICALLY,  
 THEY MAINTAINED THAT THE STATE SET COAL PRICE WILL  
 NOT BE RAISED FOR A FEW YEARS. LOOSENING CONTROLS

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OVER LARGE STATE ENTERPRISES--IN PARTICULAR THEIR RIGHT TO SELL "MEANS OF PRODUCTION" RATHER THAN TRADE THEM THROUGH THE STATE MATERIALS NETWORK--IS A KEY FOCUS OF INDUSTRIAL REFORM THIS YEAR. ESTABLISHING A GREATER DIVERSITY OF MECHANISMS FOR CONCENTRATING INVESTMENT CAPITAL IS A VERY IMPORTANT ITEM ON THE REFORM AGENDA, BUT WILL NOT RECEIVE MAJOR ATTENTION FOR A YEAR OR TWO. PROGRESS HAS BEEN MADE IN PROMOTING HORIZONTAL LINKS BETWEEN ENTERPRISES AND BREAKING DOWN EXCESSIVE VERTICAL CONTROL EXERCISED THROUGH CENTRAL MINISTRIES. END SUMMARY.

4. IN A WIDE-RANGING CONVERSATION WITH ECONOMIC COUNSELOR, XU ZHEN, DIRECTOR OF THE BUREAU OF STRUCTURAL ECONOMIC REFORM, STATE ECONOMIC COMMISSION, MAINTAINED THAT THE CURRENT WIDE-RANGING ATTACK ON "UNHEALTHY TENDENCIES" (BUZHENG ZHI FENG) IN THE ECONOMY WILL NOT SLOW THE PACE OF ECONOMIC REFORM. THIS ATTACK, LED BY THE REFORMERS AND MOST RECENTLY EMBODIED IN THREE STATE COUNCIL CIRCULARS AND SPEECHES TO A PARTY RECTIFICATION CONFERENCE, HAS FOCUSED ON DIRECT PARTICIPATION BY PARTY AND GOVERNMENT OFFICIALS IN BUSINESS ACTIVITIES, (REFTEL A), UNAUTHORIZED PRICE HIKES AND RESELLING OF GOODS FOR PROFIT, AND ILLICIT FOREIGN EXCHANGE TRANSACTIONS (REFTEL B). XU MAINTAINED THAT THIS YEAR WAS A CRUCIAL ONE FOR ECONOMIC REFORM. NEW WAGE AND PRICE REFORM MEASURES MUST BE HANDLED VERY CAREFULLY, SINCE THEY TOUCH DIRECTLY ON PEOPLE'S LIVELIHOOD. ALL POSSIBLE OBSTACLES MUST BE REMOVED AND POTENTIAL DIFFICULTIES CLOSELY MONITORED AS THESE SENSITIVE STEPS ARE UNDERTAKEN. THUS, HE ARGUED THAT THE CURRENT ATTACK SHOULD BE VIEWED AS NECESSARY PREPARATION FOR THE CONTINUATION OF REFORM, NOT AS A SIGN THAT THE PROCESS HAS BOGGED DOWN. FOREIGNERS SHOULD NOT REACT, HE INSISTED, THE WAY MANY DID TO THE CAMPAIGN AGAINST SPIRITUAL POLLUTION IN THE FALL OF 1983. XU COMPARED THE COURSE OF REFORM TO THE FLOW OF THE CHANGJIANG: ONCE PAST THE DIFFICULT STRETCHES WHICH LIE AHEAD FOR THE NEXT YEAR OR TWO, THE REFORM PROCESS WILL ENJOY SMOOTH SAILING, JUST AS THE CHANGJIANG DOES AFTER IT EMERGES FROM THE DIFFICULT PASSAGE THROUGH THE THREE GORGES.

5. XU SAID THAT THE CURRENT SYSTEM OF DUAL OR

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MULTIPLE PRICES FOR MANY GOODS WAS LIKELY TO CONTINUE FOR SOME TIME. THIS REFERS TO THE DIFFERENCE IN PRICE FOR THE SAME PRODUCT BETWEEN THE STATE SET PRICE FOR WITHIN-PLAN DISTRIBUTION AND SALES, AND A HIGHER FLOATING OR FREE PRICE FOR OVERQUOTA SALES. THE EVENTUAL GOAL HOWEVER IS TO CLOSE THE GAP BY ALLOWING THE MARKET MECHANISM (THROUGH A SUPPLY RESPONSE) TO LOWER THE FREE PRICE AND RAISING THE STATE SET PRICE. THIS SCENARIO IS THE SAME AS THE ONE ALSO RECENTLY RELATED TO ECONOMIC COUNSELOR BY JI CHONGWEI, LEADING MEMBER OF THE STATE COUNCIL'S ECONOMIC RESEARCH CENTER. JI ALSO NOTED THAT THE PRESENT REALITY OF MULTIPLE PRICES HAS NOT RESULTED FROM A CONSCIOUS POLICY DECISION BY THE GOVERNMENT. RATHER, IT IS A SPONTANEOUS RESPONSE TO THE GRADUAL EXPANSION OF THE SCOPE OF FLOATING AND FREE PRICES, AND THE GOVERNMENT BELIEVES IT IS WORKING FAIRLY WELL.

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(COMMENT: JI DID NOT SPELL OUT WHY THE GOVERNMENT APPROVES, BUT WE BELIEVE ONE REASON IS THAT IT HAS BEGUN THE PROCESS OF PRICE REFORM BUT ITS RELATIVELY GRADUAL PACE AVOIDS THE UNACCEPTABLE DISRUPTION THAT MIGHT ACCOMPANY A MORE RAPID FREEING OF PRICES. END COMMENT).

6. XU ZHEN COMMENTED SPECIFICALLY ON ENERGY PRICES, SAYING THAT STATE SET COAL PRICES WOULD NOT BE RAISED IN THE NEXT FEW YEARS. THIS IS THE CASE DESPITE THE ACKNOWLEDGED HUGE GAP BETWEEN THE CURRENT STATE AND MARKET PRICE FOR COAL (WU JINGLIAN, A COLLEAGUE OF JI CHONGWEI'S, SAID THE COAL PRICE IN THE LOWER CHANGJIANG VALLEY WAS AS HIGH AS 180 YUAN PER TON, 8-9 TIMES THE STATE PRICE), AND THE NEGATIVE EFFECT OF THE LOW STATE PRICE ON EFFORTS TO PROMOTE ENERGY CONSERVATION BY CONSUMING INDUSTRIES. THE REASON, XU SAID, IS THAT MERELY FREEING PRICES FOR COAL FROM SMALL MINES AND FOR OVERQUOTA PRODUCTION HAS CREATED SUCH A SUPPLY RESPONSE THAT TRANSPORT FACILITIES ARE MORE JAMMED THAN EVER. THUS RAISING THE STATE PRICE WOULD NOT RESULT IN GREATER SUPPLIES REACHING FACTORIES ANYWAY. FURTHER PRICE REFORM MUST BE GRADUAL TO ALLOW TRANSPORT TO CATCH UP. ALSO, HE MAINTAINED THAT A HIGHER STATE PRICE WOULD ONLY HAVE A VERY GRADUAL POSITIVE EFFECT ON CONSERVATION BECAUSE STATE AND ENTERPRISE INVESTMENT FUNDS WERE INSUFFICIENT TO PERMIT ANYTHING BUT GRADUAL PURCHASE AND INSTALLATION OF ENERGY EFFICIENT MACHINERY DESPITE THE CLEAR ADVANTAGES OF DOING SO.

7. DEVISING WAYS TO "ENLIVEN" LARGE STATE ENTERPRISES IS THE KEY ITEM ON THE AGENDA FOR INDUSTRIAL REFORM, XU MAINTAINED. HE PERSONALLY HAS BEEN DEVOTING HIS FULL ATTENTION TO THIS QUESTION FOR THE LAST SIX MONTHS. (COMMENT: XU ATTENDED THE RECENT ECONOMIC WORK CONFERENCE IN TIANJIN, AND WE SUSPECT WAS AN IMPORTANT CONTRIBUTOR TO STATE ECONOMIC COMMISSION CHAIRMAN LU DONG'S KEYNOTE REPORT ON NEW MEASURES TO LOOSEN CONTROL OVER LARGE STATE ENTERPRISES. SEE REFTEL C. END COMMENT). XU SAID LARGE STATE ENTERPRISES SUFFER FROM THREE PROBLEMS: TOO MANY "MOTHERS-IN-LAW" (PO-PODUO), CONSTRAINING POLICIES (ZHENGCE YAN) AND EVERYONE'S FEAR (DAJIA PA) THAT REFORMING THEM WILL ADVERSELY AFFECT THEIR ABILITY TO PROVIDE THE BULK OF BOTH NATIONAL OUTPUT AND STATE REVENUE. AMONG THE NEW MEASURES DESIGNED TO REFORM THESE ENTERPRISES, XU PLACED PARTICULAR STRESS ON ALLOWING THEM GREATER FREEDOM TO SELL "MEANS OF PRODUCTION" (RAW MATERIALS AND PRODUCTION GOODS) AS OPPOSED TO "DISTRIBUTE" THEM THROUGH THE STATE MATERIALS SUPPLY NETWORK AT

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LOW STATE PRICES. THESE ENTERPRISES WILL NOW BE ABLE TO SELL GOODS IN THE FOLLOWING CATEGORIES: OVERQUOTA PRODUCTION, A CERTAIN SMALL PERCENTAGE OF WITHIN-PLAN PRODUCTION (WHICH EXISTS WITHOUT A DEFINITE BUYER BECAUSE THE PLAN IS NOT THAT TIGHT), A FURTHER PORTION OF WITHIN-PLAN PRODUCTION WHICH IS MANUFACTURED WITH INPUTS BOUGHT ON THE MARKET BY THE ENTERPRISE RATHER THAN OBTAINED THROUGH THE PLAN), AND ANY PRODUCTS LINGERING IN INVENTORY. HE ALSO NOTED THAT LARGE ENTERPRISES WILL BE GIVEN GREATER LEEWAY TO PURSUE BUSINESS ASSOCIATED WITH BUT NOT IDENTICAL TO THEIR MAIN PRODUCT LINE. IN

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OTHER WORDS, ACCUSATIONS OF BU WU ZHENG YE (PAYING LITTLE ATTENTION TO ONE'S PROPER OCCUPATION) SHOULD NO LONGER BE LEVELED AT THESE ENTERPRISES.

8. ESTABLISHING CAPITAL MARKETS IS A KEY TARGET OF FUTURE REFORM, ACCORDING TO XU. AT PRESENT THERE ARE NOT ENOUGH MECHANISMS FOR CONCENTRATING FUNDS, AND THIS ADVERSELY AFFECTS THE SCALE AND PACE OF INVESTMENT AND DEVELOPMENT. HE SAID THAT BOND SALES AND EVEN STOCK MARKETS ARE UNDER CONSIDERATION, THOUGH HE ADMITTED THE LATTER MIGHT NOT BE POSSIBLE FOR SEVERAL YEARS. XU HIMSELF VISITED THE NEW YORK STOCK MARKET IN 1984 AND WAS OBVIOUSLY FASCINATED BY ITS OPERATION.

9. XU CLAIMED MODERATE SATISFACTION WITH THE DEVELOPMENT OF HORIZONTAL TIES BETWEEN ENTERPRISES IN THE SAME REGION. THESE TIES CONSIST OF BUYING FROM OR SELLING TO EACH OTHER DIRECTLY, MERGING DUPLICATED FACILITIES, ETC. SUCH ACTIVITIES HAVE BEEN IMPOSSIBLE BECAUSE OF THE STRONG VERTICALIZATION OF CONTROL THROUGH THE CENTRAL MINISTRIES. XU COLORFULLY DESCRIBED THE PROBLEM AS A SITUATION WHERE TWO NEARBY ENTERPRISES OF DIFFERENT MINISTRIES "COULD NOT TALK OF ROMANCE, AND NEVER THINK OF MARRIAGE, WITHOUT FIRST CONSULTING THEIR PARENTS (THEIR SUPERVISORY ORGANIZATION)." ENCOURAGING SUCH HORIZONTAL COOPERATION IS ONE KEY WAY THAT CENTRAL CITIES CAN PLAY A MORE IMPORTANT ECONOMIC ROLE.

10. COMMENT: XU EVIDENCED A VERY OPEN AND PRAGMATIC APPROACH TO REFORM WHICH APPEARS CHARACTERISTIC OF CURRENT ECONOMIC POLICY MAKERS. HE WAS OPEN TO CRITICISM AND WILLING TO DEBATE DIFFERENCES OF OPINION. HE HAS TRAVELED WIDELY -- TO EASTERN EUROPE, SINGAPORE, AND JAPAN IN ADDITION TO THE U.S. -- AND OBSERVED PERCEPTIVELY THE ECONOMIC SYSTEMS OF THOSE COUNTRIES AND THEIR POSSIBLE APPLICATION TO CHINA.

11. WE BELIEVE THE CURRENT ATTACK ON "UNHEALTHY TENDENCIES" MAY SLOW THE PACE OF REFORM, AT LEAST IN THE SHORT RUN, MORE THAN XU SUGGESTS. THE PURPOSE OF THE ATTACK IS TO STOP PARTICULAR ACTIVITIES THE GOVERNMENT DEEMS INCONSISTENT WITH REFORM. HOWEVER, ITS NEGATIVE TONE -- DON'T DO THIS AND DON'T DO THAT -- IS BOUND TO MAKE EVERYONE THINK TWICE BEFORE INITIATING, OR APPROVING, ANYTHING INNOVATIVE WHICH BEIJING HAS NOT SPECIFICALLY ENDORSED. ENCOURAGEMENT OF THIS INITIATIVE IS ONE IMPORTANT AIM OF THE REFORMS, AND AN IMPORTANT INGREDIENT IN THEIR CURRENT MOMENTUM. END COMMENT. HUMMEL

END OF MESSAGE

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